the first time and reflects planned adjustments in the firm's plant and equipment. It is based on the least cost technology currently available, the cost of which can reasonably be estimated based on available data. Finally, TELRIC is based on reasonable capacity projections of the extent to which the equipment (or facilities) being studied will actually be utilized, rather than the theoretical maximum.

Q. How did you determine the TELRICs of Ameritech Illinois' interconnections?

A. We determined the TELRICs of Ameritech Illinois' interconnections for this proceeding in accordance with the same forward-looking cost-based methodology as we used to determine TELRICs for unbundled network elements in other proceedings that are now pending before this Commission.

We first determined the underlying costs of the network functions used to provide the interconnection. We then assigned a TELRIC based on the interconnection's individual consumption of total network capacity. We used as a starting point an earlier forward-looking incremental cost study that was prepared for the FCC.

Q. How did Ameritech Illinois derive its TELRICs?

A. We identified the resources, such as material, software, and labor, required to satisfy the demand for particular services, in each case assuming state-of-the-art technology and excluding costs that do not vary with demand for those services. We treated each of these resources either as assets to be capitalized for future recovery or as current one-time operating expenses. Investments in resources that were to be used over a long period of time, such as outside plant cable and local switching equipment, were capitalized. We converted such capital investments to annual charges, consisting of recovery of the investment (i.e., depreciation), cost of capital, and income taxes associated with the investment. We designated those resources that involved a one-time cost, such as the labor cost of processing a service order, as nonrecurring expenses. We designated other costs, such as maintenance costs and ad valorem taxes, as recurring operating expenses. The formulae for these computations have been incorporated into computer programs to facilitate the process. We also conducted special studies to identify the labor and other items to be included in the costs of such other cost components.

Q. **Are the Ameritech Illinois TELRIC studies consistent with Ameritech Illinois' LRSIC studies of retail services?**

A. Generally, yes. The basic principles, methodologies, and cost models are the same as those that have been used in Ameritech Illinois retail LRSIC studies for years. The Commission has consistently found those studies to be in compliance with the Illinois Cost of Service rule. In addition, the principles and processes used in the calculation of LRSICs and TELRICs are exactly the same. That is, the application of LRSIC principles and processes develops the cost of services, and the application of the same principles and processes to network components develops TELRICs. However, we did modify certain assumptions from those used in prior LRSIC retail cost studies for purposes of the TELRIC studies filed in this proceeding.

Q. Please describe the assumptions that have been modified from those used in prior LRSIC retail cost studies.

A. We have adopted modified assumptions for depreciation lives and cost of capital that we believe are more appropriate for TELRIC costing pursuant to the Act.

Q. Why did you modify depreciation lives in developing Ameritech Illinois' TELRICs?

A. Economic depreciation lives should reflect, as the FCC recognized, "the true changes in economic value of an asset." First Report and Order, ¶ 703. Ameritech Illinois recognized that some of the depreciation lives it had used in prior retail studies do not reflect true economic changes in value of the assets underlying its unbundled network elements. We therefore found it necessary to shorten depreciation lives from those used in the earlier studies to reflect the risk associated with added competition and increased demand for state-of-the-art products and services that is developing.

Q. How did you determine the appropriate depreciation lives in developing Ameritech Illinois' TELRICs?

A. I used the same depreciation lives as were used in developing the TELRICs for the unbundled network elements and interconnections that Ameritech Illinois has recently submitted to the Commission.

Q. Why did you modify the cost of capital rate in developing TELRICs for Ameritech Illinois' interconnections and unbundled network elements?

A. As the FCC recognized, the increased risk of investing in a competitive local exchange service market "can and should be captured" in TELRIC. First Report and Order, ¶ 687. Accordingly, we increased the cost of capital rate to reflect the higher risk of investing in the emerging highly competitive environment. Competition is likely to increase certain financial and business risks of the local exchange business to investors — risks that historically have not been major concerns. These include high operating leverage (a high ratio of fixed-to-variable costs), low asset portability, and a higher churn (customer change) rate.

Q. What cost of capital rates did you determine to be appropriate?

A. We used the same cost of capital rate, 11.5%, as we used in developing the TELRICs for unbundled network elements that have recently been submitted to this Commission. This rate was selected based upon the fact that it is the same as that used by Ameritech in its other four states since September, 1995, in all cost studies (with the exception of recent cost studies filed in Ohio where Ameritech Ohio is proposing to

use an overall cost of capital of 13.6%) and is the same as that used by Ameritech Illinois in making investment decisions.

Q. After developing the TELRICs, did Ameritech Illinois reasonably allocate shared and common costs to the provision of interconnections and unbundled network elements?

A. Yes. First, we made sure that no costs properly attributed to TELRICs were improperly attributed to shared or common costs. Second, we engaged a team of independent consulting accountants from Arthur Andersen ("Andersen") to analyze the proper allocation of shared and common costs to each unbundled network element. The Andersen team was instructed to bring to our attention any incremental costs that previously had been considered shared or common, but that properly should be directly attributed to an individual element, so that we could incorporate such costs into our TELRICs. Andersen did locate several such costs, for example, one-time planning and implementation costs of $9.037 million which were amortized annually over 3 years ($3.012 million), and these have been incorporated into our TELRICs. The sum of the TELRICs that I identified and the shared and common costs that Andersen identified and apportioned – namely, a 29.6% shared/common loading factor –

represent the total costs used to establish Ameritech Illinois' prices for interconnection.

Q. What cost elements have been developed for frame relay interconnection?

A. Costs (recurring and nonrecurring) have been developed for Hubbed Network-to-Network Interface Connection (H NNI) for 56 Kbps, 64 Kbps and 1.544 Mbps. Costs (recurring and nonrecurring) for Hubbed NNI Connection, that allows a customer to cross-connect a frame relay NNI to a higher speed service at a designated Frame Relay Access Point, have been developed. Costs (recurring and nonrecurring) have also been developed for Data Link Connection Identifier (DLCR) and Committed Information Rate (CIR). The costs have been developed assuming a minimum contract term of twelve months for frame relay interconnection. The costs are shown in Exhibit 1 to my testimony.

Q. Why are there more rate elements in Ameritech's FCC Access Tariff than are being presented here?

A. Costs have been developed for the service ICI, Inc. has requested, that is to interconnect their frame relay network with Ameritech's. The additional rate elements in Ameritech's FCC Tariff #2 are for end user customers to

connect their premises equipment, excluding frame relay switches, to frame relay switch.

Q. Did you develop costs for reciprocal compensation for the transport and termination of frame relay traffic?

A. No. The FCC has made very clear, in ¶ 176 of its First Report and Order, that interconnection under section 251(c)(2) of the Act does not encompass reciprocal compensation, and I understand that ICI, in its petition for arbitration, raised only interconnection as an issue, and not reciprocal compensation. The cost elements that I developed for this proceeding therefore include only the costs of interconnection, not costs associated with the transport and termination of traffic.

Q: Do the bulk of Ameritech Illinois' costs reflect charges that are paid by Ameritech Illinois to an affiliate company for frame relay switching?

A: Yes, most of the costs – the item identified as "Other Recurring Expense" on pages 1, 2 and 3 of Exhibit 1 – are payments that Ameritech Illinois makes to Ameritech Advanced Data Services for Frame Relay switching.

Q: How do we know that those are reasonable forward-looking costs of the sort required by the 1996 Act?

A: There is no question but that the charges that Ameritech Illinois pays to AADS are a proper part of the calculation of Ameritech Illinois' forward-looking costs under section 251(d)(1) of the Act. These are real costs that Ameritech Illinois incurs when it purchases Frame Relay switching from AADS. If the question is meant to suggest that the amounts that AADS charges Ameritech Illinois must themselves meet the requirements of section 251(d)(1), that just is not the case.

Q. Do Ameritech Illinois' proposed prices for frame relay interconnection exceed the stand alone cost of those interconnections?

A. In my opinion, the answer is no. There is simply no reason to believe that Ameritech Illinois' proposed prices even remotely approach stand alone costs. Ameritech Illinois' cost development reflects considerable economies of scope. Further, all functions covered in the shared and common costs, which were only partially allocated to network elements and interconnections under Ameritech Illinois'

methodology, would be assignable in full to network elements and interconnections in a stand alone model.

Q. Has Ameritech Illinois included any embedded or residual costs, or economic profit in its prices for interconnections?

A. No. Although Ameritech Illinois believes that all its actual costs, including embedded and residual costs, are recoverable under the Act in the prices for interconnections and unbundled network elements, and that the Act entitles it to an additional economic profit, the prices contained in Schedule 1 reflect only TELRIC, shared, and common costs.

Q. Does that conclude your testimony?

A. Yes, it does.